FILED

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF ALABAMA

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U.S. DISTRICT COURT
N.D. OF ALABAMA

SOUTHERN DIVISION

UNITED STATES OF AMERICA	)	CR-03-C-0183-S
	)	
v.	)	
	)	
KAY MORGAN	)	

RULE 11(f) FACTUAL BASIS FOR GUILTY PLEA

COMES NOW the United States of America, through its undersigned counsel, for the purpose of satisfying the requirements of Federal Rule of Criminal Procedure 11(f), submits the following Factual Basis in support of the guilty plea of **KAY MORGAN:**

HealthSouth

1. *HealthSouth Corporation* (*"HealthSouth*") was formed in 1984. *HealthSouth* is the nations largest provider of outpatient surgery, diagnostic imaging and rehabilitative health care services with over a thousand locations in all 50 state and abroad. Since around 1998, *HealthSouth's* common stock has been listed on the New York Stock Exchange. Many of its executives, including its Chief Executive Officer ("CEO"), either owned shares in *HealthSouth,* or owned options to such shares. The CEO, and others, were also compensated in part by bonuses. The bonuses depended on how well *HealthSouth* performed financially.

2. *HealthSouth*, like other companies whose shares were publically traded, generated and publicized earnings expectations. Stock market analysts did the same. Whether a company met, exceeded, or failed to meet such expectations, was often a factor that influenced the price of its shares.

3. Since in or about 1986, when it made its Initial Public Offering (IPO), *HealthSouth* has been an issuer of a class of securities registered under Section 12 of the Securities Exchange Act of 1934, and has been required to file quarterly and annual statements under said Act with the Securities Exchange Commission ("SEC"). These statements reported *HealthSouth's* earnings, as well as the value of its assets and liabilities. These reports were available to the public, which used them to determine whether *HealthSouth* met the aforesaid expectations.

The Conspiracy

Beginning at least in or about 1997, the CEO, senior management, including William T. Owens and Weston Smith, and others at *HealthSouth* conspired to inflate the financial statements filed with the SEC.

4. The conspirators caused false entries to be made in *HealthSouth's* books and records for the purpose of artificially inflating *HealthSouth's* earnings. Methods included making entries to reduce offsets against revenues or to reduce expenses. Corresponding fraudulent entries were made to increase assets and decrease liabilities on *HealthSouth's* Balance Sheet. Such changes were made in *HealthSouth's* (1) Property, Plant and Equipment ("PP&E) accounts; (2) cash accounts; (3) inventory accounts; and (4) intangible asset (goodwill) accounts.

5. These entries caused the quarterly and annual financial statements filed with the SEC for the years from before 1998 to 2002 to be materially false. The cumulative inflations summed to over one billion dollars.

6. The CEO and other conspirators benefitted from the conspiracy by receiving salaries, bonuses, and an increased value in their stock and stock options. The investing public suffered to the extent they paid for shares whose value was inflated by the aforesaid conspiracy.

The Defendant

7. Defendant MORGAN was first employed by *HealthSouth* as an Accounting Assistant in November, 1987 in the accounting department. Although MORGAN had less than one year of college and had taken only a few courses, including an accounting course, she worked very hard at *HealthSouth* and was promoted over the years to Accounting Supervisor, Accounting Manager, Assistant Vice-President, Vice-President, and to her last position of Group Vice-President in Finance, a position she has held for approximately three years. She reported to HealthSouth senior officials and managers, including *HealthSouth*'s Controller and Chief Financial Officer, Weston Smith and William T. Owens who were involved in the aforesaid scheme.

8. Defendant Morgan was part of "family" meetings that were conducted from time to time by *HealthSouth* senior management to discuss the financial condition of *HealthSouth* and the scheme to artificially inflate earnings of the company. These "family" meetings went back several years and included senior management as well as other persons who worked at levels comparable to Morgan.

9. Beginning approximately in late 1999 and early 2000 Morgan was instructed by senior management, including Smith and Owens, during "family" meetings to "park" cash on the general ledger cash account as her part of the scheme to inflate *HealthSouth's* earnings to meet the Wall Street "expectations" and projections. The CFO Owens and others would give the defendant Morgan the dollar figures that she needed to park in the cash account and the other side of the transaction would be put in a suspense account or other account. The CFO Owens knew the earnings number that *HealthSouth* had to reach to meet the "street" number. The

defendant Morgan understood that this was the number *HealthSouth* would use for its financial statements. The defendant Morgan was told initially by senior officials, including Owens and Smith, that this was a "temporary" situation and that "there was a plan to fix" these false entries; however, the situation was never fixed, became a permanent problem , and continued to grow.

10. To keep up with the amount of the cash overstatement on the general ledger the defendant Morgan utilized one account, the PNC Bank account. The PNC account was an existing account for the deposit of funds at *HealthSouth.* The defendant MORGAN was responsible for reconciling *HealthSouth's* bank statements to the general ledger accounts. The bank statements and the ledger numbers were required to balance. To carry out and conceal the scheme and the false entries to the ledger the defendant performed false reconciliations of the deposits from *HealthSouth* facilities by omitting certain reconciling items to achieve a balance. The bank statement balances would always be true numbers, but the deposits which made up the balance would be significantly understated to allow for the inflated cash number on the ledger. If the defendant Morgan had included all of the actual deposits going into the PNC Bank account as part of the reconciliation, the amount of cash would have been too great due to the large amount of "parked" cash already reflected on the books. The defendant Morgan " parked" more than $300 million in false entries to cash on the corporate books of *HealthSouth*. This action had the effect of materially misrepresenting the amount of cash available to *HealthSouth*.

11. The defendant Morgan was aware that the falsified cash figures were used in *HealthSouth's* 10-Q and 10-K reports, which were filed with the SEC on a quarterly and annual basis. She was not involved in the filing of the reports, but knew that the false cash entries on *HealthSouth's* corporate books and records materially mistated the true financial condition and earnings of the company.

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